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C O N F I D E N T I A L SECTION 01 OF 03 BRUSSELS 000952

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SUBJECT: EU WORKING ON A GAS TRANSIT DEAL WITH TURKEY

Classified By: EST CHIEF THOMAS SMITHAM FOR REASONS 1.4 (b) AND (d)

¶1. (C) Summary. After working level discussions with Turkey last week, the EU Commission is optimistic they may be nearing an agreement with Turkey on gas transit. Turkey appears willing to drop its hold-up tactics, allow direct contracting between gas consumers and gas suppliers, will require no lift-off clauses, and is willing to establish a cost-based transit regime. In return, the EU is willing to sponsor major investment in Turkmenistan to create a large volume flow through Turkey. EU Nabucco Coordinator Jozias Van Aartsen and the Commission have moved away from the idea of pushing one pipeline (Nabucco) over all others and are instead focused on opening up the Southern Corridor to whichever pipeline or pipelines can succeed. July 18 will be a key date for this process. Turkish Energy Minister Guler, EU Energy Commissioner Piebalgs, and Van Aartsen will be meeting and Commission officials are hopeful they will be able to come to a political agreement on transit. End Summary.

¶2. (C) On June 19, 2008 EST Officer met with Brendan Devlin and Kittie Nyitrai, assistants to EU Nabucco Coordinator Jozias Van Aartsen, to discuss the possibility of the EU and Turkey reaching a gas transit agreement. Devlin and Nyitrai are optimistic that they may have the genesis of a deal with Turkey on transit after recent discussions. In a nutshell, Devlin said that Turkey appears willing to drop its hold-up tactics, allow direct contracting between gas consumers and gas suppliers, will require no lift-off clauses, and is willing to establish a cost based transmission regime. In return, the EU is willing to sponsor major investment in Turkmenistan to create a large volume flow through Turkey. Devlin views Azerbaijan as unaffected and able to do as it wishes. Iranian gas supplies are not on the table for discussion.

¶3. (C) On June 16 EU Commission officials from the Transport and Energy Directorate (DG-TREN), Energy Charter Treaty officials, and Turkish energy officials from BOTAS and the Turkish Ministry of Foreign Affairs (MFA) held a seven-hour-long, working-level meeting to discuss the gas transit question. Present from EU side were Brendan Devlin, Christopher Ross (DG-TREN, Policy Officer for Central Asia, China, and the Caucuses) and Ulrike Hauer (Trade, Economy, and Agriculture Counselor, Delegation of the European Commission to Turkey). Present from the Turkish side were Mr. Goskel (The Turkish Nabucco Coordinator), Mr. Dauzyol (CEO of BOTAS), Mr. Aydin (the BOTAS commercial gas manager), and Ms. Evren from the Turkish MFA. Present from the Energy Charter Treaty Secretariat were Ralf Dickel (Director for Trade, Transit, and Relations with Non-signatories) and Gonuz Gurbal (Senior Expert).

## Transit Agreement Possible

14. (C) The Turkish side agreed they would consider splitting commercial (purchase) issues out from transportation if the volumes of gas to be transported were increased. In that scenario, transportation would be subject to cost based transmission fees and direct contracts (producer to consumer) would be allowed. The EU side insisted on no commercial exclusivity and Turkey agreed. Increasing the volumes could be accomplished through book building -- a mechanism to consolidate gas orders and match up supplies by bringing together information from the consumers about how much gas they will need and sharing that information with the producers so they would know how much gas they should invest to produce. If book building does go ahead it will be subject to DG-Competition buy-in. If book building goes ahead outside the Nabucco context, then a special purpose vehicle is needed, according to Devlin.

15. (C) As a preliminary idea, a "Caspian Development Corporation (CDC)" - a notional title used for convenience - was discussed, which would operate the book building. CDC could be a purchase joint venture or a stand-alone entity, basically a clearing and settlement mechanism. At this point it is not clear which option will be pursued. This transit deal would make BOTAS happy because it guarantees a future role for them. It would also make the Commission happy because that role will not give Botas or Turkey a monopoly on transit. July 18 will be a key date for the process. Turkish Energy Minister Guler, EU Energy Commissioner Piebalgs, and Van Aartsen will be meeting and

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will hopefully be able to come to a political agreement on transit.

## Intergovernmental Agreement

16. (C) Turkey will consider possible extension of an Inter-Governmental Agreement (IGA) to Georgia and Azerbaijan. Turkey will consider a kick-off Ministerial to mandate negotiators. Turkey understood the need to respect EC competence issues and the EC understood that a mechanism will be needed to give Turkey a level of comfort on investment issues. If Georgia and Azerbaijan are brought in, then the IGA will have to be as simple as possible and agreements will have to be broken down in to components. The EC understood that the IGA was a way for Turkey to circumvent domestic legal procedures allowing development of Nabucco and/or the Southern Corridor.

## Increasing Caspian Volumes

17. (C) Devlin indicated that the EU concept of gas supplies for the Southern Corridor is that first gas will come from Azerbaijan, but the real key for gas supply is Turkmenistan. As an example, Devlin said that development of Turkmenistan's Iolotansk field could provide 90 bcm for 30 years. The onshore field was offered to the German's in 2006 and is still, presumably, not committed to the Russians or other buyers. Devlin foresees the way forward as getting the transit arrangement worked out with Turkey and then going to Turkmenistan and telling them they'll take the gas from Iolotansk. The EU would also give big political and financial guarantees to Turkmenistan. In discussions, the Turkish side made it clear that in opening gas flow from the Caspian region they will have to "piggy-back" on the EU.

## Van Aartsen Now Pushing "Southern Corridor" Concept

18. (C) According to Devlin, Van Aartsen and the Commission have moved away from the idea of pushing one pipeline (Nabucco) over all others and are instead focused on opening up the Southern Corridor to whichever pipeline or pipelines can succeed. Devlin believes the EU will need a variety of pipelines going forward. Nabucco is a 30 bcm project, but

the DG-TREN estimates the EU will need 50 to 100 bcm by 2020.

Their 2025 target is 120 bcm. This change in focus may not be politically popular with countries like Poland for whom Nabucco has become a talisman or for countries like Austria and Germany who have commercial interests involved. Devlin does not believe German RWE and Austrian OMV want to increase gas volumes for Europe. They want to insure gas supplies, but not so much that it removes their pricing power in their individual markets. The operative issue for the EU going forward is volume building.

¶9. (C) Once the political agreement with Turkey is reached, the EU would like to bring together an EU-Turkey-Georgia-Azerbaijan Summit to nail down a commitment on the route for the Southern Corridor, declaring that it will go from Azerbaijan through Georgia, Turkey, and on to Europe and that a Black Sea option will not be pursued. Once the transit agreement has been reached, the route is declared, and a CDC mechanism exists to consolidate demand, the EU will go to Turkmenistan to propose a deal. This will include providing EU guarantees to take the gas with the EU assuming the volume risk and the price risk.

¶10. (C) According to Devlin, the biggest short-term threat to the whole process is that Turkey is not taking this seriously enough. There are those in the Commission who are in favor of publicly pushing the Black Sea option as way to remind Turkey that it is serious. The Commission is hearing from Member States that they don't want to get pulled in to Turkish political battles that could affect gas supply. According to Devlin, Turkey is in danger of overplaying its hand. Austria, Germany, Bulgaria, and France have all expressed concerns about being vulnerable to Turkish threats to cut off gas supplies if things don't go the Turkish way on EU accession. In Devlin's view, the Commission is partly to blame for Turkey's attitude. DG-Enlargement for many years has been talking up Turkey's importance as an "energy bridge." Unfortunately, in Devlin's opinion, Turkey has bought into the hype.

¶11. (C) Devlin believes the Turkish decision on Gaz de France

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(GDF) was a very bad move because it showed that Turkey is willing to play politics with its energy policy. This helped feed fears by the French and others that Turkey will be willing to use energy for political purposes in the future -- you give me what I want on accession or I'll make life difficult for you with gas supplies. Turkey could have accomplished the same thing in a quiet manner without out getting people excited; doing it in a large public manner is, according to Devlin, "just stupid."

Using South Stream as a Bargaining Chip

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¶12. (C) Asked how Gazprom's South Stream pipeline project fits into this equation, Devlin emphasized that South Stream has no Commission status. It will not receive any Commission status as a project of European interest, but at the same time the Commission can't stop the Russians from working on South Stream. Devlin views South Stream as a useful negotiating tool with Turkey and is confident that the EU would be able to delay South Stream if necessary to allow other preferred pipeline solutions to go forward. According to Devlin, the Commission has come up with a new doctrine: any new pipeline projects must have EU regulatory approval. The aim is to put discretionary tools at the hands of the Commission to be able to hold up the Nord Stream and South Stream pipeline projects if needed to get a Trans-Caspian pipeline. The current feeling in the Commission is that they will only allow Nord Stream and South Stream to go forward on a regulatory basis if they get the Trans-Caspian pipeline. Privately, the Commission is of the opinion that all the agreements signed so far with EU members on South Stream are illegal. At some point, the Commission plans to go forward with legal action on these agreements. The Commission's

strategy is to make all routes seem viable until the Turks make a deal. Until then, the Commission views South Stream as their best negotiating tool, providing useful pressure on Turkey.

¶13. (C) The Commission has told Moscow that it has no objection to Gazprom injecting gas into Nabucco as long as the injection takes place in Azerbaijan and not Turkey (Baku, not Blue Stream for injection). The EU and Russia have come to a gentleman's agreement not to openly bad mouth each other's projects. Devlin is encouraged by recent public statements by Russian President Medvedev that South Stream and Nabucco are not competitors. Devlin pointed out that South Stream is actually nothing more than Blue Stream II redirected. Russia couldn't come to terms with Turkey to expand Blue Stream so they redirected the people, money, and equipment to South Stream as a way to bypass not only Ukraine, but also Turkey. In Devlin's opinion, Turkey overplayed its hand with Russia and is in danger of doing the same with the EU.

¶14. (C) Comment: Devlin's boss Van Aartsen is viewed as an independent negotiator who does not necessarily speak for the Commission, however, the proposed transit deal has been briefed all the way of the chain to EU Energy Commissioner Andris Piebalgs and there appears to be general support for it within DG-TREN. The first hurdle to wrapping up a transit deal will be elevating this from the working level to the Ministerial level without injecting politics into the negotiation. Even if the EU and Turkey do reach an agreement, the proposed structure is based on greatly increased gas volumes flowing through the Southern Corridor. Increasing these volumes will in turn depend on convincing Turkmenistan to allow the investment and development needed to bring new gas fields on line. Furthermore, the Commission is playing a dangerous game in allowing South Stream to move forward because, while it may prove useful in negotiations with Turkey, the apparent momentum being gained by South Stream may well discourage companies and governments from pushing forward with Nabucco and other pipeline options. End Comment.

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